IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 4 of 1992

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE
and
Hon'ble MR.JUSTICE A.M.KAPADIA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES

2. To be referred to the Reporter or not? : YES

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the concerned Magistrate/Magistrates,Judge/Judges,Tribunal/Tribunals? : NO

COMMISSIONER OF INCOME-TAX

Versus

MRINALINI V SARABHAI

Appearance:

1. INCOME TAX REFERENCE No. 4 of 1992
MR MANISH R BHATT for Petitioner No. 1
MR RK PATEL for Respondent No. 1

CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE A.M.KAPADIA

Date of decision: 01/07/2003

ORAL JUDGEMENT

(Per : MR.JUSTICE A.R.DAVE)

At the instance of the revenue, the following question of law, arising from an order passed by the Income Tax Appellate tribunal Ahmedabad Bench 'C', has been referred to this court under the provisions of sec. 256(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') for its opinion :

"Whether, on the facts and in the circumstances of the case, the Tribunal is right in law in confirming the order made by the CIT(A) deleting the disallowance made by the ITO attracting the provisions of sec. 40A(3) of the I.T. Act, 1961?"

2. Senior Standing Counsel Shri M.R. Bhatt has appeared for the applicant-revenue whereas learned advocate Shri R.K. Patel has appeared for the respondent-assessee.

3. The undisputed facts giving rise to this reference, in a nutshell, are as under :

4. The assessee had appointed a firm, named, M/s. Chidambaram (hereinafter referred to as 'the firm'), as an agent, who used to look after the financial affairs of the assessee and the said firm also used to make and receive payments on behalf of the assessee as per instructions given by the assessee. Very often when the assessee had to make payment to a particular person and had also to receive money from that particular person, the said firm used to make necessary adjustments in the account of the assessee and the final resultant figure was either paid on behalf of the assessee or was received on behalf of the assessee by the said firm. An instruction given by the assessee to the firm for making payment on behalf of the assessee was known as 'pay order'. It is pertinent to note that the term 'pay order' used by the assessee would not denote or mean a cheque or any such other instrument.

5. In pursuance of the aforesaid arrangement made by the firm, the firm used to look after the financial affairs of the assessee. For the Assessment Year 1981-82, with which we are concerned, the assessee had given certain instructions to the firm for making some payments and in pursuance of the said instructions or 'pay orders', the firm had made payments to several

persons including M/s. Sikhar Investments Pvt. Ltd., Utpal Investments Pvt. Ltd. and M/s. Vividh Investments Pvt. Ltd. The said companies used to render certain services to the assessee. It is not in dispute that the firm had made payments to the above named companies and other persons by account payee cheques and no cash transaction had ever taken place either between the assessee and the firm or between the firm and the other persons to whom payments were made by the firm on behalf of the assessee.

6. As per the above arrangement, certain final payments, after making necessary adjustments or "havalas" in the nature of expenditure, were made to the above named companies by the firm on behalf of the assessee. The ITO disallowed some of such expenditure under the provisions of sec. 40A(3) of the Act on the ground that the assessee had given 'pay orders' to the firm and the firm had not made the entire payment to the concerned companies by crossed cheques or crossed bank drafts as required under the said Section.

7. The case of the assessee before the ITO was that the firm used to look after the financial affairs of the assessee and the firm was also maintaining ledger account of the assessee. The assessee used to pay some amount "on account" to the firm and from that amount, in pursuance of instructions received from the assessee, the firm used to make payments. As stated hereinabove, payments were made by account payee cheques by the firm to the concerned persons. The ITO did not accept the explanation of the assessee to the effect that the case of the assessee was covered under the provisions of rule 6DD(j) of the Income-tax Rules, 1962 (hereinafter referred to as "the Rules") and he disallowed in all a sum of Rs. 12,000/-.

8. Being aggrieved by the assessment order, the assessee preferred an appeal before the CIT (Appeals). The CIT (Appeals) allowed the appeal and deleted the disallowance.

9. Being aggrieved by the order passed by the CIT (Appeals), the revenue filed an appeal before the Tribunal and the said appeal was dismissed by the Tribunal.

10. In the aforesaid circumstances, the abovestated question has been referred to this court for its opinion.

11. Senior Standing Counsel Shri M.R. Bhatt has

submitted that the amount of expenditure was rightly disallowed by the ITO under the provisions of sec. 40A(3) of the Act. It has been submitted by him that there were plenty of chances of having underhand dealings by virtue of the arrangement made by the assessee as observed by the ITO. It has been also submitted by him that the arrangement of making payment in pursuance of 'pay order' was not proper and, therefore, the ITO was absolutely justified in disallowing the sum of Rs. 12,000/- under sec. 40A(3) of the Act.

12. It has been also submitted by him that the explanation given by the assessee was rightly not accepted by the ITO. It has been submitted by him that the assessee could not satisfy the ITO that the payments could not be made by a "crossed cheque drawn on a bank or by a crossed bank draft" due to exceptional or unavoidable circumstances or because the payment, except in the aforestated manner, was not practicable or would have caused genuine difficulty to the payee. According to the Sr. Standing Counsel, the said method was also not adopted by the assessee for expeditious settlement of the transactions, which the assessee had with the above named persons.

13. So as to substantiate his arguments, the learned counsel has relied upon the judgments delivered in the case of Hasanand Pinjomal v. CIT, Gujarat, 112 ITR 134 and in the case of CIT, Amritsar v. Kishan Chand Maheshwari Dass, 121 ITR 232. He has also referred to the judgment delivered by the Hon'ble Supreme Court in the case of Attar Singh Gurmukh Singh v. ITO, Ludhiana, 191 ITR 667 so as to show that sec. 40A(3) of the Act had been enacted by the legislature to curb the "chances and opportunities to use or create black money" and it has been submitted by him that by deleting the said sum of Rs. 12,000/-, the ITO had made an effort to see that underhand dealings or chances and opportunities to use or create black money are substantially curbed.

14. On the other hand, learned advocate Shri Patel appearing for the assessee has submitted that in the instant case the amount of expenditure was in fact paid by account payee cheques and not in cash as believed by the ITO. He has drawn our attention to the appellate order passed by the CIT (Appeals) and the order passed by the Tribunal, which clearly show the fact that the amount had not been paid in cash as believed by the ITO. He has also drawn our attention to the fact that the term "pay order" was improperly understood by the ITO. As a matter of fact, no amount was paid under 'pay orders' as

believed by the ITO. He has explained to us that the term 'pay order' denotes instruction given by the assessee to the firm with regard to making payment to the creditor of the assessee to whom the assessee had to make the payment. By virtue of the 'pay order', no amount was paid but the term 'pay order' referred to in the assessment order was nothing more than an intimation or instruction given by the assessee to the firm to make payment of a particular amount to a particular person and when such an instruction or intiamtion was given to the firm by the assessee, the firm had made payment as per the said instruction to the concerned person by an account payee cheque.

15. Thus, learned advocate Shri Patel appearing for the assessee has submitted that, in fact, all payments were made by account payee cheques and no payment was ever made by cash to anybody by the assessee or by the firm. In the circumstances, it has been submitted by him that as all payments had been made by account payee cheques, the ITO was in error while disallowing the expenditure under the provisions of sec. 40A(3) of the Act. It has been submitted by him that the CIT (Appeals) and the Tribunal had rightly corrected the mistake committed by the ITO by deleting the disallowance.

16. Learned advocate Shri Patel has referred to Paras 76 to 80 of circular No.6-P (LXXVI-66) of 1968, dt. 6th July 1968 [Chaturvedi & Pithisaria's 'Income Tax Law' Fifth Edition, p. 2443]. Para 76 of the said circular reads as under;

> "76. Sub-section (3) of new section 40A of the Income-tax Act makes a provision for the disallowance of expenditure incurred in business and professions for which payment is made in an amount exceeding Rs.2,500 otherwise than by a crossed cheque drawn on a bank or a crossed bank draft. This provision will apply in respect of payments made after a date to be notified by the Government, being a date not later than 31st March, 1969. This provision is designed to counter evasion of tax through claims for expenditure shown to have been incurred in cash with a view to frustrating proper investigation by the Department as to the identity of the payee and the reasonableness of the payment."

17. By referring to the circular, the learned advocate has submitted that the ITO ought to have considered the case and should have assessed the income

of the assessee in the light of the observations made in the said circular. He has submitted that even according to the Department, as per the said circular, provisions of sec. 40A(3) of the Act have been incorporated to counter evasion of tax. According to him, in the instant case, in fact all payments were made to the concerned persons by crossed cheques. According to him, as the amount of expenditure was not paid in cash, but was paid by account payee cheques, by the firm on behalf of the assessee, even in the light of the instructions given in the departmental circular, the ITO should not have disallowed the expenditure.

18. Learned advocate Shri Patel has also relied upon the observations made in Hasanand Pinjomal (supra) to substantiate his case that sec. 40A(3) had been enacted with the objective of checking tax evasion and for ensuring that payments exceeding Rs. 2,500/- are made by crossed cheques or by bank drafts so that it can be easily ascertained whether the payment was genuine and whether it was made out of the income from disclosed sources.

19. We have heard the learned advocates at length and have also considered the judgments referred to by them as well as the relevant legal provisions. Section 40A(3) of the Act, as it stood at the relevant time, and Rule 6DD of the Rules read as under:

"Section 40A(3): Where the assessee incurs any expenditure in respect of which payment is made, after such date (not being later than the 31st day of March, 1969) as may be specified in this behalf by the Central Government by notification in the official gazette, in a sum exceeding two thousand five hundred rupees otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, such expenditure shall not be allowed as a deduction :

Provided that ... ...

Provided further that no disallowance under this sub-section shall be made where any payment is a sum exceeding two thousand five hundred rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors."

"Rule 6DD: No disallowance under sub-section (3) of section 40A shall be made where any payment in a sum exceeding two thousand five hundred rupees is made otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft in the cases and circumstances specified hereunder, namely :-

(a) ... ...

(b) ... ...

(c) ... ...

(d) Where the payment is made by -

(i) any letter of credit arrangements through a bank;

(ii) a mail or telegraphic transfer through a bank;

(iii) a book adjustment from any account in a bank to any other account in that or any other bank;

(iv) a bill of exchange made payable only to a bank.

Explanation: For the purposes of this clause ....which is established outside India.

(e) Where payment is made for the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee.

(f) ... ...

(g) ... ...

(h) ... ...

(i) ... ...

(j) in any other case, where the assessee satisfies the Income-tax Officer that the payment could not be made by a crossed cheque drawn on a bank or by a crossed bank draft -

(1) due to exceptional or unavoidable circumstances, or

(2) because payment in the manner aforesaid was not practicable, or would have caused genuine difficulty to the payee, having

regard to the nature of the transaction and the necessity for expeditious settlement thereof;

and also furnishes evidence to the satisfaction of the Assessing Officer as to the genuineness of the payment and the identity of the payee."

20. Upon perusal of the relevant portion of Section 40A(3) and the rules, it is clear that so as to avail a deduction, payment of expenditure exceeding Rs.2,500/- should be normally made by a crossed cheque drawn on a bank or by a crossed bank draft.

21. Rule 6DD of the Rules refers to certain exceptional circumstances, which permit an assessee to incur the expenditure "otherwise than by a crossed cheque drawn on a bank or by a crossed bank draft". In a case which is covered by the provisions of rule 6DD of the Rules, it becomes the duty of the assessee to furnish evidence to the satisfaction of the ITO as to the genuineness of the payment and the identity of the payee. In other words, if an assessee had incurred expenditure by making payment in cash, if he can bring his case within the exceptions provided under rule 6DD of the Rules, the expenditure can be deducted from the income of the assessee.

22. It is not in dispute that the amount, which was paid on behalf of the assessee by the firm, was not paid in cash but was paid by way of account payee cheques. As stated hereinabove, the aforestated factual position could not be denied by the Sr. Standing Counsel appearing for the revenue.

23. Unfortunately, the ITO appears to have made a mistake in understanding the term "pay order" and the manner in which the payments were made on behalf of the assessee by the firm. In fact, by virtue of the 'pay order', no amount was paid or no expenditure had been incurred. The so-called 'pay order' was nothing but an instruction by the assessee, to the firm, with regard to making payment on behalf of the assessee.

24. In the instant case, it is pertinent to note that the assessee was not making any payment directly to the concerned creditor. She had engaged a firm, which used to look after the financial affairs of the assessee. The firm used to collect and make payments on behalf of the assessee. If a particular payment was to be made to a

particular person, and if from the same person the assessee had to recover some amount, the firm, which used to keep ledger account of the assessee as well as of the debtors and creditors of the assessee, used to adjust the amount payable to or recoverable from the concerned person and used to pay or receive the final resultant amount on behalf of the assessee. The aforestated practice was duly revealed before the ITO. Somehow, the ITO believed that the said system can give 'chances and opportunities to use or create black money' and, therefore, merely on such an apprehension he disallowed expenditure of Rs. 12,000/-.

25. Upon perusal of the entire facts, it is very clear that whatever final payments had been made by the firm as an agent of the assessee, they were made by account payee cheques. If the ultimate payment in respect of the expenditure was made by a crossed cheque drawn on a bank, in our opinion, the transaction cannot be hit by the provisions of sec. 40A(3) of the Act. In our opinion, the Tribunal and the CIT (Appeals) had rightly appreciated the said fact and had set aside the assessment order passed by the ITO.

26. Even when one looks at the object with which sec. 40A(3) has been enacted, it becomes clear that the objective as observed by the Hon'ble Supreme Court in the case of Attar Singh Gurmukh Singh (supra), was not to regulate business transactions. It has observed as under:

"The terms of sec. 40A(3) are not absolute. Consideration of business expediency and other relevant factors are not excluded. Genuine and bona fide transactions are not taken out of the sweep of the section. It is open to the assessee to furnish to the satisfaction of the Assessing Officer the circumstances under which the payment in the manner prescribed in sec. 40A(3) was not practicable or would have caused genuine difficulty to the payee. It is also open to the assessee to identify the person who has received the cash payment. Rule 6DD provides that an assessee can be exempted from the requirement of payment by a crossed cheque or crossed bank draft in the circumstances specified under the rule. It will be clear from the provisions of sec. 40A(4) and rule 6DD that they are intended to regulate business transactions and to prevent the use of unaccounted money or reduce the chances to use black money for business transactions."

27. Looking to the law laid down by the Hon'ble Supreme Court, it is clear that the function of the ITO or the Assessing Officer is to see whether a transaction is genuine. In the instant case, the assessee had adopted a peculiar method of maintaining her books of accounts and having her business transactions, and according to her method, the entire work with regard to payment and collection of money was entrusted to the firm. If, in such a set of circumstances, the firm makes payment on behalf of the assessee by account payee cheques, by no stretch of imagination it can be said that there was any cash transaction or there was any possibility of having 'chances and opportunities to use or create black money.'

28. It is also pertinent to note that this court in the case of Hasanand Pinjomal (supra), way back in 1978, had interpreted the second proviso to sec. 40A(3) of the Act. This court has observed that the second proviso to sec. 40A(3) is meant for the purpose of business expediency and therefore practicability has to be judged from the angle of the businessman and not of the revenue. In the instant case, when the assessee found it practicable and expedient to entrust all her business transactions to the firm as her agent, and as the firm had made payments by account payee cheques to the concerned persons, and when identity of all persons to whom payments were made was revealed from the books of account, in our opinion, the Tribunal was justified in confirming the order passed by the CIT (Appeals), whereby the disallowance made by the ITO had been deleted.

29. For the reasons recorded hereinabove, we answer the question in the affirmative i.e. in favour of the assessee and against the revenue.

The reference stands disposed of accordingly with no order as to costs.

(A.R. Dave, J.)

(A.M.Kapadia, J.)

(hn)